mBank Hipoteczny

2017

Disclosures on Capital Adequacy of mBank Hipoteczny S.A. as at 31 December 2017

Warsaw, 2 March 2018
(update: 25 June 2018)

Contens

1. Introduction

Capital adequacy is defined as an extent to which risks taken by Bank (measured through capital requirement) can be absorbed by risk coverage capital (measured by own funds) at given significance level (a risk appetite) and at given time horizon. The Bank plans and monitors capital adequacy at two levels:

1. Regulatory requirement (Pillar I) where regulatory capital requirement is compared with regulatory own funds (regulatory capital),

2. Internal models (Pillar II) where internal capital calculated using internal methods is compared with available financial resources specified by Bank.

„Information Policy of mBank Hipoteczny S.A." defines scope and principles of publishing information on capital adequacy specified in Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, with further amendments as well as Commission Implementing and Delegated Regulations (EU) (hereinafter referred to as CRR). The information policy introduced by a resolution of the Bank's Management Board and approved by the Supervisory Board, is published on the website of Bank www.mhipoteczny.pl.

Disclosures are published on the website of mBank Hipoteczny S.A. (hereinafter referred to as Bank) at the time of the Bank's financial statements publication.

The published information is verified by an auditor, then the information is approved by the Management Board of the Bank.

Information presented are based on standalone data for Bank (the Bank has no subsidiaries) according to the requirements of the CRR Regulation are contained in the presented document.

If not stated specifically further in the report, all the amounts are presented in PLN thousand.

2. The scope of prudential consolidation

The Bank does not own any subsidiary, therefore, the following data are standalone data of the Bank. The Bank is a part of mBank Group.

3. Reconciliation of Common Equity Tier 1 capital item in relation to own funds of the institution and balance sheet in the audited financial statement

Reconciliation of equities included in the financial statement of the Bank for 2017 prepared in accordance with International Financial Reporting Standards to positions included in the own funds of the Bank as at 31 December 2017 is presented below.

Reconciliation	Financial Statement for the year 2017	Items not included in own funds and regulatory adjustments	Own funds in part regarding Common Equity Tier 1 capital
Equity	**31.12.2017**	**31.12.2017**	**31.12.2017**
Share capital:	**734 719**	**-**	**734 719**
Registered share capital	321 000	-	321 000
Share premium	413 719	-	413 719
Retained earnings:	**317 882**	**(17 573)**	**300 309**
Other supplementary capital	245 253	-	245 253
General banking risk reserve	44 800	-	44 800
Profit for the current year	27 829	(17 573)	10 256
Other components of equity	**3 800**	**(781)**	**3 019**
Valuation of available for sale financial assets	3 798	(780)	3 018
Actuarial gains and losses relating to post-employment benefits	2	(1)	1
Regulatory adjustments	**-**	**(133 865)**	**(133 865)**
Intangible assets	-	(25 324)	(25 324)
IRB shortfall of credit risk adjustments to expected losses	-	(88 720)	(88 720)
Net impairment losses on loans and advances	-	(18 482)	(18 482)
Additional Value Adjustments	-	(1 339)	(1 339)

4. Capital adequacy

The guiding principle of managing of capital in the Bank is maintaining of the capital on the level ensuring stable development of the Bank and covering of both minimum capital requirement and remaining risk categories recognised by the Bank as significant. Capital management is based on principles specified in the Banking Law and good practices.

The main aim of capital management is to ensure that capital resources to the Bank that will be sufficient to cover risk exposures, and in particular ensuring of implementation of required capitalisation within the limits of risk appetite.

The Bank manages the capital for risk covering using system of limits and early warning indicators, basing the core of the concept on principles formulated within consolidated supervision in the Capital Group, supporting implementation of strategic capital objectives. The Bank acts within Principles of capital management and planning policy which aim is to ensure effective use of available capital.

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable fundament of reinforcement of the capital basis in future periods. It allows to maintain the ratio of Common Equity Tier 1 capital (calculated as the quotient of Common Equity Tier 1 capital and total amount of risk exposure) as well as the total capital ratio (calculated as the quotient of own funds and the total amount of risk exposure) at least at the level required by supervising institution.

Strategic capital objectives of the Bank are oriented towards maintaining of both total capital ratio and Common Equity Tier 1 capital ratio on the level appropriately higher than level required by the supervising institution. It allows to maintain safe business development meeting the supervisory requirements in the long perspective.

5. Own funds

Own funds include Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. As at 31 December 2017, the Bank does not identify Additional Tier 1 capital. Detailed information on particular elements of the Bank's own funds as at 31 December 2017 are presented in point 5.1. Point 5.2 presents the structure of own funds of the Bank as at 31 December 2017.

5.1. Main information

COMMON EQUITY TIER 1 CAPITAL

Capital instruments and the related share premium accounts

As at 31 December 2017, the item Capital instruments and the related share premium accounts includes share capital and supplementary capital from the sales of shares above nominal value reduced by the Bank's costs of issuing. In case of issues that took place after 28 July 2013, in accordance with the Banking Law Act and CRR Regulation, the Bank obtained approval of the of the Polish Financial Supervisory Authority (PFSA) to classify them to Common Equity Tier 1 capital.

Capital instruments and the related share premium accounts	31.12.2017
Registered share capital	321 000
Supplementary capital from the sales of shares above nominal value	413 719
Total	**734 719**

Detailed information concerning share and supplementary capital are presented in Notes 36 and 37 of the financial statement of mBank Hipoteczny S.A. for 2017.

Accumulated other comprehensive income

The item Accumulated other comprehensive income presents unrealised gains and losses that constitute the Bank's other components of equity as at 31 December 2017 in the amount of PLN 3 800 thousand. The structure of accumulated other comprehensive income of the Bank as at 31 December 2017 is described below.

Accumulated other comprehensive income	31.12.2017
Instruments available for sale	**3 798**
- unrealized gains and losses on debt instruments	4 689
- deferred tax	(891)
Actuarial gains and losses on fringe benefits after employment period	**2**
- actuarial gains	2
- deferred tax	-
Total accumulated other comprehensive income	**3 800**

Other reserve capitals

Other reserve capitals constitute the other supplementary capital made of profit deductions and is intended for purposes specified in the articles of association or other provisions of law. As at 31 December 2017 other reserve capitals amounted to PLN 245 253 thousand.

Fund for general banking risk

The Bank allocates part of the net profit to the fund for general banking risk to cover unexpected risks and future losses. The fund for general banking risk is subject to distribution only with the consent of shareholders expressed during general meeting. As at 31 December 2017, the fund for general banking risk amounted to PLN 44 800 thousand.

Independently reviewed interim profits

In the calculation of Common Equity Tier 1 capital as at 31 December 2017 a verified net profit of mBank Hipoteczny S.A. for the first half of 2017 was included. Net profit achieved by mBank Hipoteczny S.A. in the first half of 2017 amounted to PLN 10 256 thousand. In accordance with the decision dated 11th September 2017, the Bank obtained PFSA approval for classification of net profit for the first half of 2017 to Common Equity Tier 1 capital in the amount of PLN 10 256 thousand.

REGULATORY ADJUSTMENTS/DEDUCTIONS FROM THE COMMON EQUITY TIER 1 CAPITAL

Intangible assets

In accordance with Art. 37 of the CRR Regulation, intangible assets are included in the account of Common Equity Tier 1 capital after reduction by the amount of associated deferred tax liabilities. In the calculation of Common Equity Tier 1 capital as at 31 December 2017 the amount of PLN 25 324 thousand on account of tangible assets was included.

Negative amounts resulting from the calculation of expected loss amounts

The Bank, which constitutes an institution that calculates risk-weighted exposure amounts using IRB method, is obliged to include negative amounts resulting from the calculation of expected loss amounts in the calculation of own funds. According to Article 36 (1d) of the CRR Regulation, the negative amounts resulting from the calculation specified in Articles 158 and 159 of the CRR Regulation were included in Common Equity Tier 1 capital as at 31 December 2017 in the amount of PLN 88 720 thousand.

Net impairment losses

In the item of net impairment losses as at 31 December 2017, the value of net impairment losses due to the loss of value of loans and advances in the period from 1 July 2017 to 31 December 2017 was presented, recognised in the profit and loss account in the amount of PLN 18 482 thousand. Used approach is consistent with provisions of the Commission Delegated Regulation (EU) No. 183/2014 dated 20 December 2013 that supplements the CRR Regulation in relation to technical regulatory standards regarding determination of the manner of calculation of adjustments resulting from specific and general credit risk.

Additional value adjustments

In accordance with Article 34 of the CRR Regulation, additional value adjustments have been calculated to all assets measured at fair value in accordance with the requirements of Article 105 of the CRR Regulation and included in Common Equity Tier 1 capital of mBank Hipoteczny S.A. as at 31 December 2017 in the amount of PLN 1 339 thousand.

Regulatory adjustments relating to unrealised gains and losses

In accordance with the Banking Law Act, in 2017 in the calculation of Common Equity Tier 1 capital institutions should include unrealised losses associated with assets or liabilities valuated according to fair value in the amount of 100% of their value, while unrealised profits could be valued in the amount of 80% of their value. Regulatory adjustments in the amount of PLN 781 thousand, related to unrealised profits as at 31 December 2017, constitute an item adjusting the position of the cumulated comprehensive income, referred to above.

ADDITIONAL TIER 1 CAPITAL

As at 31 December 2017, instruments that could be treated as Additional Tier 1 capital are not identified in the Bank.

TIER 2 CAPITAL

Capital instruments and subordinated loans

In accordance with the decision dated 17 December 2012, mBank Hipoteczny S.A. obtained approval of the PFSA to classify funds in the amount of PLN 100 000 thousand to supplementary funds in accordance with terms and conditions of the subordinated loan agreement concluded on 16 October 2012 between mBank Hipoteczny S.A. and mBank S.A. with a repayment date on 19 December 2022. As at 31 December 2017, the full amount of loan, that is PLN 100 000 thousand, was classified to Tier 2 capital.

In accordance with the decision dated 7 January 2016, mBank Hipoteczny S.A. obtained approval of the PFSA to classify funds in the amount of PLN 100 000 thousand to supplementary funds in accordance with terms and conditions of the subordinated loan agreement concluded on 12 November 2015 between mBank Hipoteczny S.A. and mBank S.A. with a repayment date on 15 December 2025. As at 31 December 2017, the full amount of loan, that is PLN 100 000 thousand, was classified to Tier 2 capital.

In accordance with the provisions of Commission Implementing Regulation (EU) No. 1423/2013 dated 20 December 2013, establishing technical implementing standards in the scope of requirements regarding disclosure of information on own funds of institutions in accordance with the CRR Regulation (hereinafter referred to as Regulation No. 1423/2013), the description of main characteristics of capital instruments included in own funds of the Bank as at 31 December 2017 is presented on the next page in the table prepared on the basis of a template that constitute appendix II to the Regulation No. 1423/2013.

TOTAL CAPITAL

The total capital item includes the amount of own funds of the Bank as at 31 December 2017 that constitutes the sum of Common Equity Tier 1 capital and Tier 2 capital. Own funds of the Bank as at 31 December 2017 amounted to PLN 1 104 182 thousand.

Capital instruments' main features

				Series A	Series B	Series C	Series D	Series E	Series F	Series G	Series H
1	Issuer	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.
2	Unique identifier (eg. CUSIP or Bloomberg identifier for private placement)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
3	Governing law(s) of the instrument	Polish	Polish	Polish	Polish	Polish	Polish	Polish	Polish	Polish	Polish
	Regulatory treatment										
4	Transitional CRR rules	Tier 2 Capital	Tier 2 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital
5	Post-transitional CRR rules	Tier 2 Capital	Tier 2 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital
6	Eligible at solo/(sub-)consolidated / solo & (sub-)consolidated(sub-)	Solo	Solo	Solo	Solo	Solo	Solo	Solo	Solo	Solo	Solo
7	Instrument type (types to be specified by each jurisdiction)	Subordinated loan – Polish Banking Law Act Art. 127.1	Subordinated loan – Polish Banking Law Act Art. 127.1	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	PLN 100	PLN 100	PLN 50	PLN 85	PLN 40	PLN 100	PLN 100	PLN 140	PLN 100	PLN 120
9	Nominal amount of instrument	Issue currency: PLN 100M; In reporting currency: PLN 100M	Issue currency: PLN 100M; In reporting currency: PLN 100M	PLN 50M	PLN 85M	PLN 40M	PLN 100M	PLN 10M	PLN 14M	PLN 10M	PLN 12M
9a	Issue price	100.00%	100.00%	PLN 100	PLN 100	PLN 100	PLN 100	PLN 1 000	PLN 1 000	PLN 1 000	PLN 1 000
9b	Redemption price	100.00%	100.00%	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
10	Accounting classification	Liability – amortised cost	Liability – amortised cost	Share capital	Share capital	Share capital	Share capital	Share capital	Share capital	Share capital	Share capital
11	Original date of issue	16-10-2012	16-11-2015	18-03-1999	15-03-2000	20-01-2006	23-11-2012	13-11-2014	24-07-2015	02-06-2016	08-02-2017
12	Perpetual or dated	Dated	Dated	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual
13	Original maturity date	19-12-2022	15-12-2025	No term	No term	No term	No term	No term	No term	No term	No term
14	Issuer call subject to prior supervisory approval	Yes	Yes	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
15	Optional call date, contingent call dates and redemption amount	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
16	Subsequent call dates, if applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
	Coupons / dividends										
17	Fixed or floating dividend/coupon	Floating coupon	Floating coupon	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend
18	Coupon rate and any related index	PLN WIBOR 3M+3.5%	PLN WIBOR 3M+3.5%	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
19	Existence of a dividend stopper	Not applicable	Not applicable	No	No	No	No	No	No	No	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Mandatory	Mandatory	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory	Mandatory	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary
21	Existence of the option of increasing interest or other incentives to redeem	No	No	No	No	No	No	No	No	No	No
22	Nonculmulative or cumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible or non-convertible, conversion trigger(s)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
25	If convertible, fully or partially	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
26	If convertible, conversion rate	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
27	If convertible, mandatory or optional conversion	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
28	If convertible, specify instrument type convertible into	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
29	If convertible, specify issuer of instrument it converts info	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
30	Write-down features	Not applicable	Not applicable	No	No	No	No	No	No	No	No
31	If write-down, write-down trigger(s)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
32	If write-down, full or partial	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
33	If write-down, permanent or temporary	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
34	If write-down, description of write-up mechanism	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	The lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right	The lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
36	Non-compliant transitional features	No	No	No	No	No	No	No	No	No	No
37	If yes, specify non-compliant features	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable

5.2. Own funds structure

In accordance with provisions of the Regulation No. 1423/2013, the structure of own funds based on a template that constitute appendix VI to the Regulation No. 1423/2013 is presented below. Taking into account the clarity and the value in use of the document for its recipients, in the table below the scope of disclosures is limited to non-zero items.

	Common Equity Tier 1 capital: instruments and reserves	Amount at disclosure date (as at 31.12.2017)
1	Capital instruments and the related share premium accounts	734 719
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	3 800
	Other reserve capital	245 253
3a	Funds for general banking risk	44 800
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	10 256
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**1 038 828**
	Common Equity Tier 1 capital: regulatory adjustments	
7	Additional Value Adjustmens	(20 602)
8	Intangible assets (net of related deferred tax liability)	(25 324)
12	Negative amounts resulting from the calculation of expected loss amounts	(88 720)
28	**Total regulatory adjustments to Common Equity Tier 1 capital (CET1)**	**(134 646)**
29	**Common Equity Tier 1 (CET1) capital**	**904 182**
44	**Additional Tier 1 (AT1) capital**	**-**
45	**Common Equity Tier 1 capital (Tier 1 capital = Common Equity Tier 1 capital + Additional Tier 1 capital)**	**904 182**
	Tier 2 (T2) capital: instruments and provisions	
46	Capital instruments and the related share premium accounts	200 000
51	**Tier 2 (T2) capital before regulatory adjustments**	**200 000**
58	**Tier 2 (T2) capital**	**200 000**
59	**Total capital (TC= T1+T2)**	**1 104 182**
60	**Total risk weighted assets**	**6 993 562**
	Capital ratios and buffers	
61	**Common Equity Tier 1 (as a percentage of risk exposure amount)**	**12.93%**
62	**Tier 1 (as a percentage of risk exposure amount)**	**12.93%**
63	**Total capital (as a percentage of risk exposure amount)**	**15.79%**
64	**Institution specyfic buffer requirement (CET1 requirement in accordance with article 92 (1) (a) of the CRR Regulation plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)**	**1.25%**
65	of which: capital conservation buffer requirement	1.25%
66	of which: countercyclical buffer requirement	0.00%
68	**Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)**	**4.93%**

6. Capital requirements

6.1. Internal capital adequacy assessment – description of the approach

mBank Hipoteczny S.A. obtained consent issued by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) on 14 August 2012 in cooperation with the PFSA (PFSA letter dated 27 August 2012) to apply internal rating methods in terms of assignment of exposures due to specialist lending to risk category (IRB slotting approach method) to calculate capital requirement due to credit risk. On the basis of consent issued on 2 April 2014 by BaFin in cooperation with the PFSA (PFSA letter dated 10 April 2014), the Bank extended applied IRB approach with further rating models.

By the letter dated 12 December 2013, the Bank informed PFSA on the extension of the plan of gradual implementation of internal rating method in mBank Hipoteczny S.A. with the class of retail exposures secured on housing real estates.

There are ongoing works at the Bank – initiated with the submission of the Prevalidation Application in H2 2016 – focusing on obtaining the consent of the supervision authority to acquire via the A-IRB method the retail portfolio obtained within the scope of cooperation with mBank S.A., based on the adaptation of the models applied in mBank S.A. In Q4 2017, the Bank obtained an official position from the Polish (PFSA) and the European (ECB) supervision authority, which is the result of the observations from the inspection carried out in Q4 2016, as well as of the answers of the Bank to the initial evaluation results, addressed at the beginning of 2017 by the PFSA.

A substantial part of the recommendations identified during the inspection was addressed by the Bank in 2017, however the mBank Group intends to fulfil all the expectations of the supervision authority in in 2018, which shall result in the submission in 2018 of the final Request for the application of the statistical methods for calculating the capital requirements for the credit risk for the retail portfolio acquired within the scope of the cooperation with mBank S.A.

In the calculation of total capital ratio of the Bank as at 31 December 2017, the total capital requirement was designated taking into account the capital requirement due to credit risk with application of the IRB method in accordance with provisions of the CRR Regulation and also own funds were designated with an application of deduction resulting from the IRB approach and were at the level higher than 80% of comparative total capital requirement (so called regulatory floor), in accordance with provisions of the CRR Regulation.

6.2. Results of the internal capital adequacy assessment

The key element of the risk management process in the Bank is the mechanism that assumes maintaining of own funds on the level that provides the ability to absorb unexpected losses due to any types of risks resulting from the business activity conducted by the Bank. This aim is implemented in the scope of ICAAP (Internal Capital Adequacy Assessment Process) which through mechanisms of estimation of adequacy of internal capital reinforces associations between risk profile (level), risk management mechanism and owned capital.

Through the implementation of the ICAAP, the Bank performs current and future assessment of capital adequacy in the context of necessity to maintain it, even in very difficult economic conditions and ensures that an institution owns adequate internal capital in relation to the risk profile. The process is subject to regular reviews implemented by the Management Board of the Bank and is supervised by the Supervisory Board.

Internal capital is value estimated by the Bank that is necessary to cover all significant types of risks identified in the operations in the scope of risk inventory process - it constitutes the sum of economic capital used to cover types of risks included in the process of calculation of economic capital and the capital used for covering of remaining types of risks (including hard to quantify risks).

Economic capital is determined using appropriate quantitative methods allowing for reflection of the degree of risk in an adequate manner. Currently total economic capital covers the following elements:

- economic capital to cover credit risk,

- economic capital to cover market risk,
- economic capital to cover operational risk,
- economic capital to cover business risk.

Capital for covering remaining types of risks (including hard to quantify risks) is estimated in accordance with the rules defined in the ICAAP.

The risk management system is associated with capital and process management at its planning. Risk appetite is defined as acceptable level of risk specified in terms of value and expressed using internal capital, which is defined by the Risk Management Strategy of the Bank.

6.3. Additional information about using the internal ratings-based approach

6.3.1 Clarification and review of controls on rating systems (including a description of the degree of their independence and scopes of responsibilities) and a review of the rating systems

As regards the portfolios subject to the IRB approach, the rating models used in specialised lending within the commercial portfolio are subject to monitoring which is performed at least once a year by the model Owners who are independent of the model Users. The monitoring comprises analyses carried out at the individual case level, as well as portfolio analyses. More frequent verification of a rating system by the model Owners is dependent on the occurrence of factors (internal and/or external) which may contribute significantly to a change in the value of a model's component parameters. The effectiveness of a rating system's elements is also tested on a current basis by the model Owners in the case of default loans.

The rating models for the commercial portfolio are also subject to annual validation performed by a Validation Unit which is independent of the units responsible for building, rebuilding and using the rating models at the Bank. The validation of the rating system for specialised lending is qualitative and quantitative in nature. The scope of qualitative validation covers, among other things, evaluating the rules for constructing a model, testing the theoretical correctness and the correctness of implementation of the rating models, and analysing the quality of the data used for building the model. In quantitative validation, the main object of evaluation is the functioning of a model in terms of the discriminant power of the model, as well as the stability of the model.

The rating system for specialised lending is also subject to the annual reviews of the Bank's rating systems. As part of the review, the Internal Audit Department evaluates corporate governance, the principles of segmentation and the correctness of determination of capital requirements, stress tests used in assessing capital adequacy, the integrity of the process of assigning ratings, credit risk mitigation methods, and the data quality management process.

6.3.2 Description of factors which affected the losses incurred in the previous period

As regards the portfolios subject to the IRB approach – the commercial portfolio, specialised lending with the use of supervisory categories – the Bank calculates impairment allowances on the basis of an individual analysis and a portfolio analysis (exposures for which no impairment was identified in the individual analysis). The Bank does not use the PD and LGD parameters as defined in its own estimates of the parameters according to an internal rating model for measuring impairment for this portfolio. The Bank measures impairment for credit exposures in accordance with International Accounting Standard 39.

The amount of the losses incurred in 2017 was lower than the amount of the losses incurred in 2016. The main reasons behind the fall included: the relative improvement with regard to the expected recoveries related to the confirmed default cases, no need to create write-downs for new default cases, and improved factors impacting LGD estimates in the portfolio analysis – an improvement of the ratio indicative of the relation of the engagement value to the collateral value.

6.4. Supervisory requirements for capital ratios

The Bank maintains capital ratios above minimal levels that result from provisions of the CRR Regulation, as well as above levels that were expected from the Bank in 2017 by the banking supervision (total capital ratio – 13.25%, Tier 1 capital ratio – 10.25%).

Strategic capital objectives of the Bank are oriented towards maintaining of both total capital ratio and Common Equity Tier 1 capital ratio on the level appropriately higher than level required by the supervising institution. It allows to maintain safe business development meeting the supervisory requirements in the long perspective.

Capital ratios are calculated on the basis of the total amount of risk exposure, corresponding to the sum of risk exposure amounts for particular types of risks, calculated in accordance with provisions of the CRR Regulation.

6.5. Quantitative data regarding capital adequacy

The total amount of risk exposure of the Bank as at 31 December 2017 consists of:

- risk-weighted exposure amount for credit risk, counterparty credit risk, calculated using the IRB slotting approach and a standardised approach for exposures permanently excluded from the IRB approach as well as exposures subject to temporary exclusion,
- operational risk exposure amount, calculated using basic indicator approach.

There is no trading portfolio in the Bank, therefore, the Bank does not calculate risk-weighted exposure amounts in relation to other types of risks.

		RWAs	Minimum capital requirements
		31.12.2017	31.12.2017
1	Credit risk (excluding CCR)	6 766 529	541 322
2	Of which the standardised approach	2 739 889	219 191
3	Of which the foundation IRB (FIRB) approach	4 026 640	322 131
6	CCR	3 405	273
7	Of which mark to market	3 405	273
23	Operational risk	223 628	17 890
24	Of which basic indicator approach	223 628	17 890
29	**Total**	**6 993 562**	**559 485**

The table below presents credit exposures for which the requirement was calculated using the IRB slotting approach broken down into supervisory categories of risk as at 31 December 2017.

Specialised lending							
Regulatory categories	Remaining maturity	On- balance-sheet amount	Off-Balance-sheet amount	Risk weight	Exposure amount	RWAs	Expected losses
Category 1	Less than 2.5 years	-	-	50%	-	-	-
	Equal to or more than 2.5 years	2 660	-	70%	2 667	1 866	11
Category 2	Less than 2.5 years	250 865	139 976	70%	251 423	175 996	1 006
	Equal to or more than 2.5 years	3 924 602	1 207 413	90%	3 933 330	3 539 997	31 467
Category 3	Less than 2.5 years	8 390	-	115%	8 408	9 670	235
	Equal to or more than 2.5 years	219 201	-	115%	219 688	252 642	6 151
Category 5	Less than 2.5 years	89 842	-	-	120 672	-	60 336
	Equal to or more than 2.5 years	124 536	-	-	188 789	-	94 394
Total	**Less than 2.5 years**	**349 097**	**139 976**		**380 503**	**185 666**	**61 577**
	Equal to or more than 2.5 years	**4 270 999**	**1 207 413**		**4 344 474**	**3 794 505**	**132 023**

Standardised approach – Credit risk exposure and CRM effects

		a)	b)	c)	d)	e)	f)
		Exposures before CCF and CRM		Exposures post CCF and CRM		RWAs and RWA density	
	Exposure classes	On-balance-sheet amount	Off-balance-sheet amount	On-balance-sheet amount	Off-balance-sheet amount	RWAs	RWA density
1	Central governments or central banks	1 278 478	-	1 278 478	-	-	0%
2	Regional government or local authorities	62 566	-	200 443	-	40 089	20%
3	Public sector entities	61 318	-	-	-	-	0%
6	Institutions	31 747	-	31 747	-	6 505	20%
7	Corporates	76 559	-	-	-	-	0%
8	Retail	1 171 748	167 378	1 171 748	83 689	941 610	75%
9	Secured by mortgages on immovable property	4 753 781	46 617	4 753 781	23 309	1 741 056	36%
10	Exposures in default	9 945	80	9 945	40	10 621	106%
15	Equity	8	-	8	-	8	100%
17	**Total**	**7 446 150**	**214 075**	**7 446 150**	**107 038**	**2 739 889**	**36%**

Exposures under the standardised approach by asset class and risk weight

	Exposure classes	Risk weight							Total	Of which unrated
		0%	20%	35%	50%	75%	100%	150%		
1	Central governments or central banks	1 278 478	-	-	-	-	-	-	1 278 478	1 278 478
2	Regional government or local authorities	-	200 443	-	-	-	-	-	200 443	200 443
6	Institutions	18 737	-	-	13 010	-	-	-	31 747	-
8	Retail	-	-	-	-	1 255 384	15	38	1 255 437	1 255 437
9	Secured by mortgages on immovable property	-		4 682 802	-	-	78 712	15 576	4 777 090	4 777 090
10	Exposures in default	-	-	-	-	-	8 712	1 273	9 985	9 985
15	Equity	-	-	-	-	-	8	-	8	8
17	**Total**	**1 297 215**	**200 443**	**4 682 802**	**13 010**	**1 255 384**	**87 447**	**16 887**	**7 553 188**	**7 521 441**

7. Capital buffers

On the basis of the Act on macroprudential supervision over the financial system and crisis management in the financial system as well as the relevant amendment to the Banking Act, starting from January 2016 mBank Hipoteczny S.A. has been obliged to maintain specific capital buffers:

- Conservation buffer ratio of 1.25%;
- Countercyclical buffer ratio specific to institutions, which currently amounts to 0%.

The foreign credit exposures in mBank Hipoteczny S.A. represent less than 2% of the total risk-weighted exposures, therefore, in the table on the geographical distribution of the relevant credit exposures for the purpose of calculating a countercyclical buffer the entire portfolio was allocated to Poland. In the table, the exposures from the following countries were allocated to the location of the institution: Germany, Austria, the United States, Belgium, and Switzerland, which represent a total of 0.007% of the total value of the Bank’s original exposures.

The geographical distribution of the relevant credit exposures for the purpose of calculating a countercyclical buffer as at 31 December 2017

	Country	General credit exposures		Own funds requirements		Own funds requirement weights	Countercyclical capital buffer rate
		Exposure value for SA	Exposure value IRB	Of which: General credit exposures	Total		
		010	020	070	100	110	120
010	Poland	6 041 839	4 724 977	590 384	590 384	100	-

The amount of the countercyclical buffer specific to institutions as at 31 December 2017

	Amount of institution-specific countercyclical capital buffer	
010	Total risk exposure amount	6 673 466
020	Institution specific countercyclical buffer rate	-
030	Institution specific countercyclical buffer requirement	-

8. Leverage ratio

The regulatory leverage ratio as at 31 December 2017 was calculated on the basis of the provisions of Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio (hereinafter: “Regulation 2015/62”).

The leverage ratio is calculated as a measure of Tier 1 capital divided by the total exposure measure and is expressed as a percentage. The total exposure measure is the sum of the exposure values specified in accordance with Regulation 2015/62 in respect of all assets and off-balance sheet items not deducted when determining the measure of Tier 1 capital.

The Tier 1 capital for the leverage ratio was calculated in accordance with Regulation 575/2013, using the national options defined in Article 171a of the Banking Act.

The table below presents information regarding the leverage ratio as at 31 December 2017 and the division of the total exposure measure which makes up the leverage ratio in accordance with Commission Implementing Regulation 2016/200 (EU) of 15 February 2016 laying down implementing technical standards with regard to the disclosure of the leverage ratio for institutions, according to Regulation (EU) No 575/2013 of the European Parliament and of the Council (hereinafter: “Regulation 2016/200”).

	On-balance sheet exposures (excluding derivatives and SFTs)	
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	12 121 880
2	(Asset amounts deducted in determining Tier 1 capital)	(134 646)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)**	**11 987 234**
	Derivative exposures	
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	50 781
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	19 519
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(48 030)
11	**Total derivatives exposures**	**22 270**
	Other off-balance sheet exposures	
17	Off-balance sheet exposures at gross notional amount	1 561 525
18	(Adjustments for conversion to credit equivalent amounts)	(1 319 718)
19	**Other off-balance sheet exposures**	**241 807**
	Exempted exposures in accordance with Article 429(7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)	
EU-19a	**(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet)**	**(34 197)**
	Capital and total exposure measure	
20	**Tier 1 capital**	**904 182**
21	**Leverage ratio total exposure measure**	**12 217 114**
	Leverage ratio	
22	**Leverage ratio**	**7.40%**
	Choice on transitional arrangementsand amount of derecognised fiduciary items	
EU-23	Choice on transitional arrangements for the definition of the capital measure	Transitional

The table below presents the reconciliation of the total exposure for calculating the leverage ratio to the value of the assets in the Bank’s published financial statements for 2017.

		31.12.2017
		Applicable Amount
1	Total assets as per published financial statements	12 168 169
4	Adjustments for derivative financial instruments	(26 699)
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	241 807
EU-6A	(Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013)	(34 197)
7	Other adjustments	(131 966)
8	**Leverage ratio total exposure measure**	**12 217 114**

Disclosure of qualitative information about the risk of excessive leverage and the factors which affect the leverage ratio.

	Disclosure of qualitative items	
1	Description of the processes used to manage the risk of excessive leverage	Bank has the excessive leverage risk management policy. It defines the organizational framework and regulates the process of managing the risk of excessive leverage in the Bank. It contains the scope and division of responsibilities in the management of the risk of excessive leverage, as well as steps of risk management.
2	Description of the factors that had an impact on the leverage Ratio during the period to which the disclosed leverage Ratio refers	Leverage ratio has incerased by 0.33 p.p. as at 31th of December 2017 compared to end of December 2016 due to higher total exposure and own funds increase.

The leverage ratio is subject to constant monitoring. The Bank monitors the level of leverage ratio on the basis of quarterly information, analyses possible significant changes and their reasons.

The level of the leverage ratio above 5% is recognised as safe and does not require any additional actions. In case of decline of the ratio below indicated level, the ALCO Committee will consider taking appropriate actions.

In the scope of applicable management information system, the report on the current level of leverage ratio and possible risks regarding maintaining safe levels of the factor, taking into account the influence of current losses and losses possible to predict in the future, the influence of current dynamic and planned dynamics of lending activity is submitted to the ALCO Committee. The process of analysis is implemented through the control of implementation of strategy, plans and financial projection.

9. Applied credit risk mitigation techniques

9.1 Assessment of collaterals and their management

The policies and processes for on- and off-balance sheet netting

Financial assets and financial liabilities are offset and the net amount is reported in the statement on financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realise the asset and settle liability simultaneously.

The main types of guarantor and credit derivative counterparty and their creditworthiness

As at 31 December 2017, the Bank did not own derivative credit instruments.

Collaterals

Credit risk taken by the Bank by means of providing loan products to clients may be reduced through collaterals. Types of collaterals accepted by the Bank and the principles of their establishment are described in detail in the internal regulations of the Bank.

The rules of valuation of loan collaterals and collateral management are described in applicable policies and procedures of the Bank. An important element of the collateral policy is an assumption that by taking decision on granting of a product that bears credit risk, the Bank aims to obtain a collateral of the highest quality and value adequate to the scale of risk.

Fulfilment of a protective role by a collateral occurs in accordance with conditions discussed in the part "Main types of collaterals". The Bank regularly monitors the quality of collaterals, the monitoring covers in particular the effectiveness of the legal establishment of the collateral, valuation of the collateral and validity of documentation, e.g. assignment of rights from collateral agreement.

Collaterals on real estates

In the process of granting mortgage loans, the Bank assesses and determines the value of collaterals in accordance with provisions of the Act on Covered bonds and Mortgage Banks and the Regulations of determining the mortgage lending value of the property (hereinafter the Regulations) approved by the PFSA.

The process of determining the mortgage lending value of the property (hereinafter BHWN) is implemented by employees of the Bank who meet competence requirements specified in the Regulations. The basis for determining of BHWN is an expert's opinion on the mortgage lending value developed in accordance with regulations applicable in the Bank. BHWN determined by an employee of the Bank ensures adequacy of collateral over the whole duration of agreement and constitutes a basis for indicating of maximum amount of loan, in accordance with provisions of the Act on Covered bonds and Mortgage Banks.

Retail area (portfolio of loans granted in cooperation with mBank S.A.)

The Bank carefully selects real estates that may constitute a subject of collateral. The scope of process of collateral assessment covers analysis of features of a real estate proposed for collateral and analysis of liquidity of a local market of similar real estate resulting with assignment of a real estate to specified segment, i.e. typical/unusual real estate. Applied segmentation aims to ensure assumed effectiveness of recovery from accepted collateral.

The Bank applies additional limitations in the scope of relation of loan amount to the level of determined actual amount, reflecting the current level of prices for similar real estate available on the market. The indicator may not exceed:

- 80% of determined actual volume for typical residential real estates,
- 70% of determined actual volume for unusual residential real estates.

In case of covering a loan with insurance of low own contribution, the Bank allows for granting of a loan in the amount exceeding the abovementioned ratios, however, not more than up to the established BHWN.

The Bank periodically monitors the value and quality of owned legal collaterals of mortgage loans portfolio. In the scope of this process for residential real estate, the Bank analyses changes in prices of real estates on the market in order to identify evidence of impairment for a credit exposure.

Corporates

The Bank observes the rule that in accordance with the Act on Covered bonds and Mortgage Banks the value of LTV ratio must not exceed 100%. Additional information furthermore, in the Credit Policy of the Bank maximum values of the LTV ratio were determined that depend on the type of financed real estate and are as follow[1]:

- 90% for office, commercial and warehouse properties and
- 80% for housing developers and hotels.

The Bank periodically monitors the value of real estates that are the subject of collateral. The monitoring also covers collaterals entered into the Cover Register. The principles of monitoring of the value of collaterals are described in detailed internal regulations of the Bank.

In the scope of corporate loan monitoring, the legal status of real estates, on which mortgages are established for the Bank, is verified. The verification is done through reviewing of a land register via website of the Ministry of Justice.

The validity of insurance policies of real estates that constitute mortgage collateral for the Bank is monitored and reported to the Management Board of the Bank in monthly cycles.

[1] The Bank defined three levels of criteria: fully accordant with the Credit Policy of the Bank, exclusion from the Credit Policy and not covered by the Credit Policy (knock-out criteria)

9.2. Main types of collaterals

Retail

- Mortgage on real estates

A mortgage on a financed (or other) real property is a basic collateral for mortgage loans. The Bank accepts only a first charge mortgage entry. The mortgage registration equals 150% of the original loan exposure. The Bank secures itself only on those real properties the type of right to which was indicated in the Act on Covered bonds and Mortgage Banks (exclusion relates to cooperative ownership right).

- Bridging insurance

For loans, for which the target collateral has the form of a mortgage on a real property, a so- called "bridging insurance" is used up until the time when that mortgage is established.

- Assignment of rights from insurance policy against fire and other accidents of a mortgaged real property

In case of all loans secured with a mortgage on a real property, the Bank requires provision of insurance of a real property against fire and other accidents in the entire duration of the loan agreement.

- Claim for establishing of a mortgage in the future

In case of loans granted for purchase of a real property from a developer, until removal of a purchased real property from a land register kept for a real property covered with investment, a claim for establishing of a mortgage on a purchased real property in the future is entered for the Bank in section IV. This collateral is provided in the Act on Covered bonds and Mortgage Banks and is applied alongside bridging insurance.

- Transfer of receivables from development agreement

In case of loans granted for purchase of a real property from a developer, the Bank requires transfer of receivables resulting from agreement concluded between the developer and the client, which, in case of a failure of a final agreement, secures the Bank’s claim in terms of paid amount of loan.

Corporates

In case of mortgage loans, the basic collateral is a mortgage on a financed real property. The Bank accepts only a first charge mortgage entry. The Bank secures itself only on those real properties the type of right to which was indicated in the Act on Covered bonds and Mortgage Banks.

Additional collateral is applied by the Bank in case of loans in the corporate area:

- declaration of submission to enforcement under Art. 777 of the Code of Civil Procedure;
- assignment from lease agreements;
- assignment from insurance policy;
- pledge on shares of the company owned by the borrower or pledge on shares of the company of the borrower’s general partner;
- pledge on the bank account of the borrower;
- power of attorney to the bank account of the borrower;
- promissory note guaranteed by sponsors or partners as a transition collateral until the time of establishing of a mortgage on a real property.

Public sector

In case of loans for local government units (JST) and loans guaranteed by JST granted to special purpose companies established by them and health care institutions, mandatory legal collaterals of repayment of a granted loan are:

- for JST - Blank promissory note of the Borrower together with bill declaration;
- for health care institutions and special purpose companies established by JST - JST guarantee according to civil law;

The following may constitute an additional collateral of repayment of a loan:

- mortgage on real property;
- assignment of rights from insurance policy of construction against all construction risks of a real property;
- assignment of rights from insurance policy against fire and other accidents of a mortgaged real property;
- assignments or a pledge on receivables due to lease agreements;
- bank guarantee;
- pledge on rights, including pledge on shares of a special purpose company;
- accession to a loan debt.

Values of exposures per type of recognised collateral broken down to exposure classes are presented in Note 6.3 to this document. As a recognition of a collateral, the Bank uses unfunded credit protection in a form of guarantees of local government units that meet the requirements of the CRR Regulation.

9.3. Market or credit risk concentration

Due to the fact that the scope of activity is limited by an act, the Bank is exposed to increased risk of concentration on the real property market. Taking this into account, the Bank aims for maximum available diversification of credit risk and avoiding its excessive concentration, which consists in limiting of involvement in single entities and groups of affiliated investors. Thus understood limitation is achieved through systematic increasing of share of retail mortgage loans in the balance sheet of the Bank.

To actively manage the concentration risk, the Bank has an internal system that limits the market and credit risk concentration. At the same time, the Bank observes supervisory guidelines regarding the limits of lending and concentration. Risk limits are threshold values the observance of which aims to ensure implementation of objectives given the available resources. The structure and the level of limits is established by the Management Board of the Bank, and all cases of exceeding of internal concentration limits are reported to the Management Board of the Bank immediately after their occurrence.

Due to increasingly greater differentiation between particular segments of real property market, the Bank takes into account the concentration into separate types of financed real property while developing the policy of income producing real estate and sales plans as well as in current credit decisions in a given segment. The Bank has established and monitored exposures in particular segments of the real estate market, appropriately to the risk associated with them.

Additionally, the Bank monitors the market for its geographical differentiation in order to identify markets with variable saturation in particular real estate segments. For that reason, the Bank controls the risk resulting from geographical concentration through establishing and monitoring of limits for financing of projects in particular provinces.

Having regard to limitation of concentration of risk resulting from exposure in the same currency, the Bank monitors the currency structure of exposure portfolio on a monthly basis.

The Bank controls the concentration limits of exposures to single entity or group of entities related by equity or organisationally, which amounts to 25% of eligible capital of the Bank, and additionally on a daily basis monitors exposures for exceeding of 10% of the eligible capital of the Bank in relation to a single entity or group of entities related by equity or organisationally.

The Bank analyses key market risk concentrations associated with its operations and business events. Within risk concentration analysis, the Bank monitors e.g. influence of changes of market risk factors, such as: exchange rates, interest rates..

10. Credit risk adjustments

10.1. Past due and impaired exposures– definitions used

Definition of past due exposures

The exposures against clients, for whom at least one receivable is past due by one or more days, are assumed as past due exposures. Whereby, in case of portfolio granted in cooperation with mBank S.A., the past due exposure is an exposure on delayed contracts (by one or more days). No impairment is recognised in respect of loans and advances past due for less than 90 days, unless other available information indicates their impairment. In rare cases for loans and advances overdue by over 90 days, the Bank does not recognise impairment if there is particular evidence demonstrating lack of impairment of those loans and advances.

Definition of impaired exposures

The Bank measures the impairment of credit exposures in accordance with International Accounting Standard no. 39.

For the purposes of impairment analysis four portfolios are distinguished in the Bank:

- retail portfolio obtained in cooperation with mBank S.A.,
- commercial portfolio,
- JST portfolio,
- portfolio of remaining retail loans.

Commercial portfolio is divided into two sub-portfolios, distinguishing commercial loans (developer loans, commercial loans and loans for legal persons) and other loans for individual entrepreneurs.

Credit exposure is considered to be burdened with evidence of impairment when for a debtor (owner of the contract) an evidence of default is identified.

The Bank applies uniform definition of default in all areas of credit risk management, including for the purposes of calculation of impairment losses, provisions and capital requirement. The default definition is based on the definition included in the CRR Regulation.

The Bank assumes that a default occurred in relation to given debtors, if at least one of the following events took place:

a) any of the exposures of a client against the Bank, Bank’s parent company is pas due by over 90 days and the overdue amount exceeds PLN 500 for retail clients and PLN 3000 for other clients,

b) deterioration of counterparty/transaction credit quality. The Bank recognises that the debtor probably will not fully fulfil its credit obligations against the Bank, parent entity of the Bank without actions of the Bank, such as implementation of a collateral, if such exists,

c) qualification of an entity to a default situation by the Bank’s parent entity.

In case of retail portfolio obtained in cooperation with mBank, exceeding of threshold amount of PLN 500 occurs when the total past due amount on all credit exposures of the debtor (overdue by over 31 days) exceeds PLN 500.

Reclassification of at least one liability of a client to the default category causes reclassification of all liabilities of the client to the default category.

The following indicate deterioration of credit quality of a client/transaction in accordance with the above definition:

a) preparation of a loss impairment as a result of significant deterioration of debtor's creditworthiness,
b) sale by the Bank of an exposure with significant economic loss associated with changes in its creditworthiness,
c) the Bank's permission for forced restructuring of credit liability, if it may cause reduction of financial liabilities through amortisation of significant part of the liability or deferring of payment of the principal amount, interests or - if applicable - commission,
d) filing by the Bank of a bankruptcy motion against debtor or filing similar motion in respect of credit obligations of the debtor towards the Bank, the parent of the Bank,
e) declaration of bankruptcy of a debtor or obtaining by the debtor of similar legal protection, causing avoidance or delay of repayment of credit liabilities against the Bank, Bank's parent company.

For portfolios of corporate loans, JST and other retail loans apart from hard evidence (specified above) that determine *default* event occurrence, the Bank identifies soft evidence. Occurrence of a soft evidence does not automatically cause necessity for classification as a default event. Soft evidences have supplementary nature. These are issues which Bank should additionally consider during analysis of the situation of the borrower and which may indicate its deterioration. If in the Bank's opinion identified soft evidence have significant meaning for a particular case, the Bank should proceed with an assessment whether a default event occurred regardless of lack of hard evidence.

10.2. Quantitative information

Specific and general credit risk adjustments

While determining the value of exposure, the Bank applies the following adjustments due to particular credit risk:

- adjustments regarding loss impairments of exposures of individual significance,
- adjustments regarding loss impairments of exposures that are not individually significant, determined within group assessment,
- adjustments regarding impairment losses incurred as a result of events that occurred, but were not reported yet (referred to as IBNR impairment losses) for an exposure without recognised impairment

Due to application of International Financial Reporting Standards, the Bank does not apply adjustments for general credit risk.

Retail portfolio obtained in cooperation with mBank S.A.

Calculation of impairment losses on balance sheet credit exposures and provisions on off-balance sheet credit exposures in parameters based on risk determined using methodology applied for advanced method of internal ratings (AIRB) on the basis of group models applicable in mBank Group (the Bank is a local user). Those parameters are subjected to adjustments that aim to fulfil applicable regulations.

Estimation of a provision for transactions which lost their value is made on the basis of LGD model for default clients which on the basis of historical data estimates future discounted recoveries conditioned by a type of transaction, the level of its security, the time the client is in a default state and occurrence of delay.

Retail loan portfolio, JST and other retail loans

The Bank calculated loss impairments on the basis of individual analysis (commercial and JST portfolio) and portfolio analysis (retail portfolio and those exposures from the commercial and JST portfolio for which no value loss was identified in the individual analysis).

In case of no evidence of impairment against credit exposure, in the portfolio analysis an impairment loss is calculated for incurred, but not identified losses.

The portfolio analysis covers all retail and commercial loans not covered by the individual analysis. The Bank applies estimated parameters for the purposes of impairment measurement specifying the rate of healing (ZLGD), indicator of faulty collaterals (BD) and indicator of relationship between recovery and the value of collateral (CRR), as well as individual for each exposure indicator of relationship between a debt and the value of collateral (LTV) used for determination of LGD in the portfolio analysis and additionally parameters PD and LIP. The Bank assumes that LIP amounts to 8 months for the commercial loan portfolio and 12 months for retail loans. PD parameter is currently determined using 3 year time series. LGD parameter is estimated on the basis of data from 2009, selection of the scope of data is made in order to ensure adequacy of estimation of the amount of impairment losses to current economic conditions. Each of separated portfolios has its own set of ZLGD, BD, CRR and PD parameters.

In case of finding of evidence of impairment, the Bank calculates impairment losses in the individual analysis for commercial and JST portfolio. The process of calculation in the individual analysis consists in:

a) determination of estimated future cash flows (repayments) both from collaterals and payments made by borrowers, including planned costs,
b) in the calculation of difference between balance sheet value of a given asset and current value of estimated profits and costs discounted with effective interest rate,
c) booking of impairment losses.

In case of evidence of impairment and individual analysis of a given credit exposure, not stating the loss of value, impairment loss is calculated on the basis portfolio parameters analysis.

In case of assets for which a permanent impairment was identified, the Bank executes stricter monitoring, e.g. revaluation of the mortgage lending value of the property constituting collateral of a loan.

Subjective distribution of exposures

The distribution of gross exposure of the Bank broken down by exposure classes and depending on the type of counterparty is presented below. The summary includes the division into the value of exposures for standard and IRB methods.

		a)	b)
		Net value of exposures at the end of the period	**Average net exposures over the period**
3	Corporates	5 967 485	5 638 885
4	Of which: Specialised lending	5 967 485	5 638 885
5	Of which: SMEs	5 967 485	5 638 885
15	**Total IRB approach**	**5 967 485**	**5 638 885**
16	Central governments or central banks	1 278 478	1 215 258
17	Regional governments or local authorities	62 566	66 093
18	Public sector entities	61 318	63 644
21	Institutions	54 016	113 029
22	Corporates	76 559	150 862
23	Of which: SMEs	76 559	150 862
24	Retail	1 339 126	1 749 596
26	Secured by mortgages on immovable property	4 800 398	4 089 429
27	Of which: SMEs	78 712	83 729
28	Exposures in default	10 025	8 413
33	Equity exposures	8	8
35	**Total standardised approach**	**7 682 494**	**7 456 332**
36	**Total**	**13 649 979**	**13 095 217**

Geographical breakdown of exposures

The summary of exposures per geographical breakdown and exposure classes as at 31 December 2017 is presented below

		a)	b)	c)	d)	e)	f)	g)	m)
		Net value							
		Poland	Austria	Germany	United States	Switzerland	Belgium	Great Britain	Total
3	Corporates	5 967 485	-	-	-	-	-	-	5 967 485
6	**Total IRB approach**	**5 967 485**	**-**	**-**	**-**	**-**	**-**	**-**	**5 967 485**
7	Central governments or central banks	1 278 478	-	-	-	-	-	-	1 278 478
8	Regional governments or local authorities	62 566	-	-	-	-	-	-	62 566
9	Public sector entities	61 318	-	-	-	-	-	-	61 318
12	Institutions	38 347	-	-	-	-	-	15 669	54 016
13	Corporates	76 559	-	-	-	-	-	-	76 559
14	Retail	1 339 093	-	-	-	33	-	-	1 339 126
15	Secured by mortgages on immovable property	4 799 698	23	142	23	512	-	-	4 800 398
16	Exposures in default	10 025	-	-	-	-	-	-	10 025
21	Equity exposures	-	-	-	-	-	8	-	8
23	**Total standardised approach**	**7 666 084**	**23**	**142**	**23**	**545**	**8**	**15 669**	**7 682 494**
24	**Total**	**13 633 569**	**23**	**142**	**23**	**545**	**8**	**15 669**	**13 649 979**

Concentration of exposures by industry or counterparty types

		c)	e)	f)	g)	i)	l)	m)	p)	r)	s)	t)		u)
		Manufacturing	**Water supply**	**Construction**	**Wholesale and retail trade**	**Accommodation and food service activities**	**Real estate activities**	**Professional, scientific and technical activities**	**Public administration and defence, compulsory social security**	**Human health services and work activities**	**Arts, entertainment recreation**	**Other services**	**Other**	**Total**
3	Corporates	-	-	2 362 214	-	18 394	3 502 361	84 109	-	-	-	407	-	5 967 485
6	**Total IRB approach**	**-**	**-**	**2 362 214**	**-**	**18 394**	**3 502 361**	**84 109**	**-**	**-**	**-**	**407**	**-**	**5 967 485**
7	Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	1 278 478	1 278 478
8	Regional governments or local authorities	-	-	-	-	-	-	-	62 566	-	-	-	-	62 566
9	Public sector entities	-	-	-	-	-	-	-	-	48 606	12 712	-	-	61 318
12	Institutions	-	-	-	-	-	-	-	-	-	-	-	54 016	54 016
13	Corporates	-	2 973	-	-	-	7 538	-	-	-	66 048	-	-	76 559
14	Retail	-	-	-	-	-	-	-	-	-	-	-	1 339 126	1 339 126
15	Secured by mortgages on immovable property	1 075	-	1 341	57	575	75 664	-	-	-	-	-	4 721 686	4 800 398
16	Exposures in default	-	-	-	-	-	-	-	944	-	-	-	9 081	10 025
21	Equity exposures	-	-	-	-	-	-	-	-	-	-		8	8
23	**Total standardised approach**	**1 075**	**2 973**	**1 341**	**57**	**575**	**83 202**	**-**	**63 510**	**48 606**	**78 760**	**-**	**7 402 395**	**7 682 494**
24	**Total**	**1 075**	**2 973**	**2 363 555**	**57**	**18 969**	**3 585 563**	**84 109**	**63 510**	**48 606**	**78 760**	**407**	**7 402 395**	**13 649 979**

The residual maturity breakdown of exposures

The summary of exposures per residual maturity dates broken down by applied methods and exposure classes within a method as at 31 December 2017 is presented below

		a)	b)	c)	d)	e)	f)
		Net exposure value					
		On demand	**<= 1 year**	**> 1 year <= 5 years**	**> 5 years**	**No stated maturity**	**Total**
3	Corporates	-	117 588	874 855	3 627 653	-	4 620 096
6	**Total IRB approach**	**-**	**117 588**	**874 855**	**3 627 653**	**-**	**4 620 096**
7	Central governments or central banks	1 351	542 629	634 948	99 550	-	1 278 478
8	Regional governments or local authorities	-	195	9 427	52 944	-	62 566
9	Public sector entities	-	249	12 712	48 357	-	61 318
12	Institutions	18 737	17 161	-	18 118	-	54 016
13	Corporates	-	693	3 688	72 178	-	76 559
14	Retail	-	40	2 308	1 169 399	-	1 171 747
15	Secured by mortgages on immovable property	-	2 457	26 643	4 724 681	-	4 753 781
16	Exposures in default	-	22	663	9 260	-	9 945
21	Equity exposures	-	-	-	-	8	8
23	**Total standardised approach**	**20 088**	**563 446**	**690 389**	**6 194 487**	**8**	**7 468 418**
24	**Total**	**20 088**	**681 034**	**1 565 244**	**9 822 140**	**8**	**12 088 514**

Credit quality of exposures by exposure class and instrument

		a)	b)	c)	g)
		Gross value (balance and off-balance sheet)		Specific credit risk adjustment	Net values
		Defaulted exposures	Non-defaulted exposures		(a+b-c)
3	Corporates	309 461	5 762 904	104 880	5 967 485
4	Of which: Specialised lending	309 461	5 762 904	104 880	5 967 485
5	Of which: SMEs	309 461	5 762 904	104 880	5 967 485
15	**Total IRB approach**	**309 461**	**5 762 904**	**104 880**	**5 967 485**
16	Central governments or central banks	-	1 278 478	-	1 278 478
17	Regional governments or local authorities	-	62 585	19	62 566
18	Public sector entities	-	61 336	18	61 318
21	Institutions	-	54 016	-	54 016
22	Corporates	-	76 582	23	76 559
23	Of which: SMEs	-	76 582	23	76 559
24	Retail	-	1 340 225	1 099	1 339 126
26	Secured by mortgages on immovable property	-	4 801 933	1 535	4 800 398
27	Of which: SMEs	-	78 863	151	78 712
28	Exposures in default	16 256	-	6 231	10 025
33	Equity exposures	-	8	-	8
35	**Total standardised approach**	**16 256**	**7 675 163**	**8 925**	**7 682 494**
36	**Total**	**325 717**	**13 438 067**	**113 805**	**13 649 979**
38	Of which: Debt securities	-	1 277 127	-	1 277 127
39	Of which: Off-balance-sheet exposures	80	1 561 445	61	1 561 464

Credit quality of exposures by industry or counterparty types

		a)	b)	c)	g)
		Gross value (balance and off-balance sheet)		Specific credit risk adjustment	Net values
		Defaulted exposures	Non-defaulted exposures		(a+b-c)
3	Manufacturing	-	1 076	1	1 075
5	Water supply	-	2 974	1	2 973
6	Construction	131 278	2 269 119	36 842	2 363 555
7	Wholesale and retail trade	-	57	-	57
9	Accommodation and food service activities	-	19 011	42	18 969
11	Real estate activities	179 967	3 475 341	69 745	3 585 563
12	Professional, scientific and technical activities	-	84 296	187	84 109
14	Public administration and defence, compulsory social security	944	62 585	19	63 510
16	Human health services and social work activities	-	48 620	14	48 606
17	Arts, entertainment and recreation	-	78 783	23	78 760
18	Other services	-	408	1	407
	Other	13 528	7 395 797	6 930	7 402 395
19	**Total**	**325 717**	**13 438 067**	**113 805**	**13 649 979**

Credit quality of exposures by geography

		a)	b)	c)	g)
		Gross value (balance and off-balance sheet)		Specific credit risk adjustment	Net values
		Defaulted exposures	Non-defaulted exposures		(a+b-c)
1	Poland	325 717	13 421 657	113 805	13 633 569
2	Austria	-	23	-	23
3	Germany	-	142	-	142
4	United States	-	23	-	23
5	Switzerland	-	545	-	545
6	Belgium	-	8	-	8
7	Great Britain	-	15 669	-	15 669
8	**Total**	**325 717**	**13 438 067**	**113 805**	**13 649 979**

Ageing of past-due exposures

		a)	b)	c)	d)	e)	f)
		Gross carrying values					
		≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year
1	Loans	279 759	12 482	23 905	1 504	94 655	130 121
3	**Total Exposures**	**279 759**	**12 482**	**23 905**	**1 504**	**94 655**	**130 121**

Non-performing and forborne exposures

		a)	b)	c)	d)	e)	f)	g)	h)	i)	j)	k)	l)	m)
		Gross carrying values of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
			Of which performing but past due > 30 days and <= 90 days	Of which performing forborne	Of which non-performing				On performing exposures		On non-performing exposures		On non-perfoming exposures	Of which forbone exposures
						Of which defaulted	Of which impaired	Of which forborne		Of which forborne		Of which forborne		
010	Debt securities	1 277 127	-	-	-	-	-	-	-	-	-	-	-	-
020	Loans and advances	10 869 756	13 273	71 099	325 637	325 637	281 124	179 764	12 430	147	101 314	54 905	307 882	168 783
030	Off-balance-sheet exposures	1 561 525	-	-	80	80	-	-	61	-	-	-	80	-

Changes in the stock of general and specific credit risk adjustments

		a)
		Accumulated specific credit risk adjustment
1	**Opening balance**	**91 651**
2	Increases due to amounts set aside for estimated loan losses during the period	30 141
3	Decreases due to amounts reversed for estimated loan losses during the period	12 434
4	Decreases due to amounts taken against accumulated credit risk adjustments	7 827
5	Transfers between credit risk adjustments	-
6	Impact of exchange rate differences	-
7	Business combinations, including acquisitions and disposals of subsidiaries	-
8	Other adjustments	(217)
9	**Closing balance**	**101 314**
10	Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	-
11	Specific credit risk adjustments directly recorded to the statement of profit or loss	-

Changes in the stock of defaulted and impaired loans and debt securities

		a)
		Gross carrying value defaulted exposures
1	**Opening balance**	**354 119**
2	Loans and debt securities that have defaulted or impaired since the last reporting period	27 369
3	Returned to non-defaulted status	518
4	Amounts written off	7 827
5	Other changes	(47 426)
6	**Closing balance**	**325 717**

CRM techniques – Overview

		b)	d)
		Exposures secured – Carrying amount	**Exposures secured by financial guarantees**
1	Total loans	137 876	137 876
3	**Total exposures**	**137 876**	**137 876**

11. Operational risk

By operational risk the Bank understand a possibility to incur loss resulting from inadequate or defective internal processes, systems, errors or activities undertaken by an employee of the Bank and external events.

While organizing the operational risk management process, the Bank takes into account regulatory requirements. Resolutions, as well as recommendations of the Financial Supervision Authority (in particular including Recommendation M) constitute starting point for preparation of the framework of control system and operational risk management.

The general principle of operational risk management in the Bank is its minimisation - limitation of causes of occurrence of operational events, reduction of probability of their occurrence and the severity of potential effects.

Operational risk control and management consists of a set of activities aimed at identifying, monitoring, measurement, assessment, reporting as well as reduction, avoidance, transfer or acceptance of operational risk, the Bank is exposed to in particular areas of its operations. It is based on quantitative and qualitative methods and tools for operational risk control.

mBank Hipoteczny is a specialised bank, established and operating on the basis of the Act of Covered bonds and Mortgage Banks. Its basic specialisation consists in ability to issue mortgage covered bonds and public sector covered bonds that constitute key sources of financing in the bank's balance sheet. This specialisation determines limited product range of the Bank. In 2017, the Bank offered mortgage loans to finance real estate in two business lines - Commercial Banking and Retail Banking. The Bank's own sales carried out by the Bank's specialists is the main source of acquiring corporate customers.

As for retail customers - before 22 July, the sale operations were carried out as part of the so-called agency model implemented in collaboration with mBank S.A., by the agency of the mBank Group branch offices and other sales channels. Since 22 July, the process has been moved to mBank. The Bank keeps its retail loan portfolio which is supposed to be larger as part of the regular pooling transactions, i.e. taking over mortgage loans granted by mBank S.A. which may make up the basis for issuing covered bonds.

The Bank has in place a fraud detection and operational risk management mechanism made up of the process of discovering fraud and recording and analyzing transaction errors and customers' complaints.

On a daily basis, the Bank monitors any changes affecting the operational risk profile. So far, the data collected does not indicate any increase of the operational risk in the retail and commercial banking line. Following the assignment of the retail loan sale process to mBank, the Bank does not expect any increased operating losses in that business line. However, both the maintained retail portfolio and the one acquired through pooling are continuously monitored.

The Bank has Business Continuity Plan that was implemented and tested within implementation of Recommendation D.

Within classification of the Bank's activity, in accordance with the CRR Regulation, the following business lines are separated:

- Trading and sales,
- Commercial banking,
- Retail banking,
- Payments and settlement.

In 2017, the risk profile was the same as in the previous year. The Bank did not record any actual losses. The identified operational events were of non-realised effects, i.e. the Bank's results or equity not included in the statement. Losses are monitored according to the following risk categories:

- Crimes committed by employees,
- Crimes committed by outsiders,
- Deliberate destruction,

- Staff habits and workplace safety,
- Customers, products and business practices,
- Natural disasters and public safety,
- IT irregularities,
- Execution, delivery and process management.

With application of database, information on losses resulting from operational risk are recorded with a focus on the reason of their occurrence and analysing for necessary corrective actions.

12. Remuneration policy in respect of persons having significant influence on the risk profile of the Bank

Information on the policy of variable remuneration

Principles of establishing variable remuneration components of persons holding managerial positions, who have significant influence on the risk profile of the Bank are specified by "Policy for remuneration of persons having significant influence on the risk profile of mBank Hipoteczny S.A.", hereinafter referred to as "Policy", adopted by the Resolution of the Supervisory Board no. 27/2015 dated 26 June 2015, which are measured and modified every year by the Bank's Management Board and the Supervisory Board.

Since then the most important changes have consisted of modifications adopted:

- in March 2017 - the Bank's Management Board and the Supervisory Board made their annual verification of the Policy and adopted amendments aimed at implementing the EBA guidelines (in force since 1 January 2017) pertaining to the remuneration policy EBA/GL/2015/22 of 27 June 2016, repealing the former CEBS guidelines dated 10 December 2010. Although there no direct legal provisions governing the admissibility of the impossibility to defer the variable remuneration of risk takers, invoking the proportionality principle and aiming at harmonizing the variable remuneration payment rules, the Commerzbank group introduced a variable remuneration payment limit for Bank employees who are not Management Board members: if the amount of the variable remuneration is equal to or higher than the limit, the Bank's Supervisory Board may decide not to defer the variable remuneration over the next years, and to allocate the whole variable remuneration in the form of non-deferred cash.

The update and implementation of the Regulation of the Minister of Development and Finance of 6 March 2017 (in force since 1 May 2017) on the risk management system and the internal control system, the remuneration policy and the detailed manner of assessing internal capital at banks (Journal of Laws 2017, item 637) will be carried out in Q1 2018.

The purpose of adopted Policy is to support proper and effective risk management, provision of making decisions not burdened with excessive risk, i.e. risk going beyond accepted by the Supervisory Board willingness to take risks by the Bank and to support implementation of strategy and limitation of conflicts of interest.

The list of positions having significant influence on the Bank's risk profile including justification of their selection are specified in a separate document accepted by the Bank's Management Board and Supervisory Board - "Policy of identification of employees having significant influence on the bank's risk profile", corresponding to the requirements of Commission Delegated Regulation (EU) no. 604/2014 dated 4 March 2014 that supplements the directive of the European Parliament and Council 2013/36/UE in relation to regulatory technical standards in relation to quality criteria and appropriate quantitative criteria of determining of categories of employees, whose professional activity has significant influence on the risk profile of the institution.

The Supervisory Board is the governing body that supervise remunerations.

In 2017 there were three meetings of the Supervisory Board.

The Bank did not use services of an external consultant while establishing "Policy for remuneration of persons having significant influence on the risk profile of mBank Hipoteczny S.A." and "Policy of identification of employees having significant influence on the bank's risk profile."

The most important information concerning the formation of remuneration

Variable remuneration includes bonuses granted to a member of the Management Board or other employees for a given financial year. Variable remuneration is established in a transparent manner, possible to verify, ensuring effective implementation of the Policy.
The maximum level of the amount of variable remuneration components of persons covered by the Policy may not exceed 100% of the basic remuneration paid to a given employee for a financial year.
Variable remuneration is part of total remuneration (annual basic remuneration and variable remuneration) for Management Board members or other employees. Variable remuneration is established taking into account market practices, in both banking sector and nationwide market, verified on the basis of market payroll reports and remuneration policy of the mBank Group.

A part of variable remuneration is paid in phantom shares. The number of phantom shares, which will be established for a member of the Management Board or other employee for a given financial year on the account of variable remuneration (both non-deferred and deferred part), constitutes a result of dividing the amount of the variable remuneration established in accordance with the Policy principles by the value of a phantom share at the end of financial year for which the remuneration is established.
The value of phantom share is the quotient of book value of the shares of the Bank and the number of ordinary shares, where the book value of the Bank is defined as: total assets reduced by total liabilities of the Bank. The book value of the Bank and the number of ordinary shares are derived from the financial statement of the Bank for a financial year for which variable remuneration is granted after its previous approval by the Supervisory Board. The number of phantom shares can take fractional values and is rounded to 4 decimal places.

Members of the Management Board

The amount of bonus for particular members of the Management Board is established by the Supervisory Board which takes into account whether a member of the Management Board completed an established annual/multi-annual business and development objective - Management By Objective ("MBO"). The decision on granting of a bonus and its amount is the exclusive competence of the Supervisory Board which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

Variable remuneration is granted in accordance with the following rules:

1) 60% of the bonus amount is granted in the year following a given financial year (non-deferred bonus):
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.
2) 40% of the bonus will be deferred to three successive years in three equal, annual tranches. Bonus within each tranche is granted to a member of the Management Board upon meeting of specified conditions, in an analogous manner as 60% of the bonus amount granted after the financial year for which the bonus is calculated, i.e.:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.

Employees who are not members of the Management Board:

The Bank's Management Board executes an annual assessment, or an assessment covering longer periods, of an employee's work and if it deems that the employee completed an established annual/multi-annual business and development objective - ("MBO"), after considering the complete amount of the employee's remuneration, may make a decision that will establish the amount of so called discretionary bonus. The decision on granting of a discretionary bonus and its amount is the exclusive competence of the Management Board of the Bank which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

MBO is established by the Management Board of the Bank (objectives must result from objectives established for the Management Board of the bank - the principle of cascading of objectives to subsequent levels of management) for subsequent financial year within a term accordant with a schedule applicable for a given year. In accordance with principles of establishing of MBO business and development objectives adopted in the Bank:

- group quantitative objectives (at the Bank's level) constitute up to 20%,
- individual quantitative objectives constitute 65% to 90% of the objectives (objectives established depending on the responsibility of a given position, objectives cascaded by the member of the Management Board that supervises that position),
- individual quality objectives constitute up to 20% of the objectives.

Variable remuneration is granted in accordance with the following rules:

1) 60% of the bonus is granted in the year following the given accounting year:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank,
2) 40% of the bonus will be deferred to three successive years in three equal, annual tranches. The bonus under each tranche is granted to an employee upon meeting specific conditions, in the same way to the 60% of the bonus granted after the accounting year for which the bonus is calculated, i.e.:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.

The costs resulting from the deferred tranches in the form of the shares are settled according to the IFRS.

Information on the criteria of performance assessment, which are the basis for the rights to the remuneration components

Members of the Management Board

Deferred tranches of the bonus granted for a given accounting year shall be issued for a member of the Management Board in three equal, annual parts.

The Supervisory Board may decide to suspend in whole or reduce the amount of deferred tranche due to subsequent evaluation of work of a member of the Management Board in a term longer than 1 financial year (i.e. for a period of at least 3 years) which takes into account the business cycle of the Bank as well as risk associated with conducting activity by the Bank, but only when actions or omissions of a member of the Management Board had direct or negative impact on financial result and market position of the Bank in the period of assessment. The aforementioned assessment of the performance of member of the Management Board (over a longer period of time) will be made annually and communicated internally at the Bank, together with the assessment of the performance of the member of the Management Board for a given period.

The Supervisory Board may decide to suspend in whole or to reduce the amount of bonus for a given financial year, also in terms of deferred tranche that has not been paid yet, in a situation referred to in Art. 142 (1) of the Banking Law Act. Suspending in whole or reduction of a bonus, as well as any deferred tranche, may also relate to a bonus and/or deferred tranche not paid to a member of the Management Board after expiration or termination of the management agreement.

Employees who are not members of the Management Board:

The deferred tranches of the discretionary bonus for a given accounting year will be issued for the employee in three equal, annual parts.

The Management Board of the Bank may decide to suspend in whole or reduce the amount of deferred tranche:

- if it finds that in a longer-term (period of at least 3 years) an employee through its actions or omissions directly and negatively impacted financial result and market position of the Bank in the assessment period. In the assessment of actions or omissions of an employee the Management Board of the Bank takes into account e.g. results of the MBO assessment of the employee,
- in case of termination of an employment contract with the exclusion of reasons specified in the employment contract/internal regulations of the Bank.

The Supervisory Board may decide to suspend in whole or to reduce the amount of discretionary bonus for a given financial year, as well as in terms of deferred tranche that has not been paid yet, in case of a balance sheet loss or threat of its occurrence or a risk of insolvency or losing of liquidity by the Bank.

Main parameters and rules for determining of remunerations of persons holding managerial positions in mBank Hipoteczny S.A., including the manner of linking of the amount of remuneration with results in case of remunerations depending on the results

Members of the Management Board

The decision on granting of a discretionary bonus and its amount is the exclusive competence of the Supervisory Board which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods. The Manager, until the end of March of a financial year following the financial year for which the so called discretionary bonus is determined, will submit to the Supervisory Board a written report on implementation of MBO for a financial year for which a discretionary bonus is determined. MBO will be determined by the Supervisory Board in consultation with the Manager for subsequent financial year until 31 December of the year preceding the financial year.

Employees who are not members of the Management Board:

Variable remuneration for employees who are not members of the Board shall be granted by the Bank's Management Board, which on the basis of the results achieved under the annual/long- term business-development objective - Management By Objectives ("MBO" defined according to the aforementioned description), after taking into account the value of the total remuneration of an employee (i. a. comparison of the employee's remuneration to the market benchmark provided by an external company specializing in the development of such data), determines the amount of the so-called discretionary bonus. Bonus is not automatically calculated and its awarding and amount depend on a joint decision of the Management Board of the Bank.

This document presents the Policy for remuneration of persons having significant influence on the risk profile of the Bank that was approved in April 2017. Remuneration programmes that were in force in previous years which were not settled yet are described in the Bank's financial statements in Note 42.

Aggregated quantitative information on remuneration broken down into senior management and employees whose actions have significant influence on the Bank's risk profile:

Aggregated quantitative information regarding remuneration broken down into areas of activity (in PLN):

Business Line	Total renumeration (fixed + variable)
Management Board members	3 523 731
Other employees	3 243 070
Total	**6 766 801**

Collective qualitative information about the remuneration of persons in managerial positions at mBank Hipoteczny S.A.

No	Information regarding	Value	Comments
1.	Number of employees	15	5 Management Board Members 10 Risk Takers
2.	Base salary paid in 2017	PLN 5 014 026	
3.	2017 variable remuneration subject to PFSA 258/2011 Resolution, granted in 2018	*	
4.	**Calculated for 2017 non-deferred component of the variable remuneration subject to PFSA 258/2011 Resolution, including:**		
4.1.	Cash	*	
4.2.	Financial instrument – number of shares, amount of the component	*	
5.	**Calculated for 2017, not yet granted deferred component of the variable remuneration subject to PFSA 258/2011 Resolution, including**		
5.1.	Cash	*	
5.2.	Financial instrument – number of shares, amount of the component	*	
6.	**Deferred component of variable remuneration prior 2017, payment possible in 2017, including:**		
6.1.	Cash	PLN 190 000	II deferred tranche of 2014 I deferred tranche of 2015
6.2.	Financial instrument – number of shares, amount of the component	PLN 272 776	Amount of: 1) III deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares , granted as bonus for 2013 2) II deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares, granted as bonus for 2014 3) I deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares, granted as bonus for 2015
		913.1835 shares	The conversion of non-cash bonus at the average price of mBank Hipoteczny S.A. phantom shares value for 1 year preceding the granting date of the bonus
7.	**Deferred component of variable remuneration prior 2017, payment not yet possible in 2017, including:**		
7.1.	Cash	PLN 633 000	
7.2.	Financial instrument – number of shares, amount of the component	PLN 656 999	Value of the deferred bonus component settled in mBank Hipoteczny S.A. shares, granted within 2014, 2015 and 2016 bonus
		2 414.3028 shares	The conversion of non-cash bonus at the average price of mBank Hipoteczny S.A. phantom shares value for 1 year preceding the granting date of the bonus
8.	Value of deferred remuneration granted in the given accounting year, paid and reduced due to an adjustment related to results	PLN 273 519	Amount of variable remuneration lost due to termination of the managerial contract / employment contract
9.	Payments related to commencement and termination of employment relationship	-	
9.1.	Number of employees who receive such payments	-	
9.2.	The highest payment	-	
10.	Number of employees who received total remuneration in the amount exceeding EUR 1 mln	-	

**The fields were not filled in due to the fact that as at 2 March 2018, i.e. as at the date of publication of this report, the variable remuneration for 2017 for the employees listed in the above table had not yet been accepted by the relevant authorities of the Bank. This document will be adjusted for the payments of the variable remuneration for 2017, awarded in 2018, after the acceptance of the financial statements for 2017 by the General Shareholders' Meeting.*

13. Remuneration policy in respect of persons having significant influence on the risk profile of the Bank - update of the information after the approval of the variable partof remuneration, regarding 2017 year, by the competent authorities of mBank Hipoteczny S.A.

Collective qualitative information about the remuneration of persons in managerial positions at mBank Hipoteczny S.A.

No	Information regarding	Value	Comments
1.	Number of employees	15	5 Management Board Members
			10 Risk Takers
2.	Base salary paid in 2017	PLN 5 014 026	
3.	2017 variable remuneration subject to PFSA 258/2011 Resolution, granted in 2018	PLN 1 885 000	
4.	**Calculated for 2017 non-deferred component of the variable remuneration subject to PFSA 258/2011 Resolution, including:**		
4.1.	Cash	PLN 1 059 000	
4.2.	Financial instrument – number of shares, amount of the component	PLN 354 000	
		1075.6608 shares	
5.	**Calculated for 2017, not yet granted deferred component of the variable remuneration subject to PFSA 258/2011 Resolution, including**		
5.1.	Cash	PLN 236 000	
5.2.	Financial instrument – number of shares, amount of the component	PLN 236 000	
		717.1073 shares	
6.	**Deferred component of variable remuneration prior 2017, payment possible in 2017, including:**		
6.1.	Cash	PLN 190 000	II deferred tranche of 2014 I deferred tranche of 2015
6.2.	Financial instrument – number of shares, amount of the component	PLN 272 776	Amount of: 1) III deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares , granted as bonus for 2013 2) II deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares, granted as bonus for 2014 3) I deferred bonus tranche settled in mBank Hipoteczny S.A. phantom shares, granted as bonus for 2015
		913.1835 shares	The conversion of non-cash bonus at the average price of mBank Hipoteczny S.A. phantom shares value for 1 year preceding the granting date of the bonus
7.	**Deferred component of variable remuneration prior 2017, payment not yet possible in 2017, including:**		
7.1.	Cash	PLN 633 000	
7.2.	Financial instrument – number of shares, amount of the component	PLN 656 999	Value of the deferred bonus component settled in mBank Hipoteczny S.A. shares, granted within 2014, 2015 and 2016 bonus
		2 414.3028 shares	The conversion of non-cash bonus at the average price of mBank Hipoteczny S.A. phantom shares value for 1 year preceding the granting date of the bonus
8.	Value of deferred remuneration granted in the given accounting year, paid and reduced due to an adjustment related to results	PLN 273 519	Amount of variable remuneration lost due to termination of the managerial contract / employment contract
9.	Payments related to commencement and termination of employment relationship	-	
9.1.	Number of employees who receive such payments	-	
9.2.	The highest payment	-	
10.	Number of employees who received total remuneration in the amount exceeding EUR 1 mln	-	